Means Testing Consumer Bankruptcy: The Problem of Means

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MEANS TESTING CONSUMER BANKRUPTCY:
THE PROBLEM OF MEANS

By Jean Braucher

In the debate over means testing of consumer bankruptcy, we sometimes forget that the current system already effectively screens out most of those who do not belong in it. Under the Bankruptcy Code, individual debtors must repay creditors using their disposable income where it would be a "substantial abuse" not to do so and also using nonexempt assets. Most individual debtors in bankruptcy do not have non-exempt assets and receive little or no income in excess of their reasonable expenses. The current debate is not really about whether to means-test bankruptcy, but about whether it is possible to do a better job of

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2. See id. § 726(a) (providing for distribution of property of the estate); see also id. § 522(b) (providing for debtors to claim exemptions). In Chapter 13, debtors must pay the value of nonexempt assets under the best interests test. Id. § 1325(a)(4).
3. About 95% of Chapter 7 cases are "no asset" ones, and most of the 5% with assets are business liquidations. See Nat'l Bankr. Rev. Com'n, Bankruptcy: The Next Twenty Years, Final Report 137 (1997) [hereinafter, NBRC Report].
4. See Marianne B. Culhane & Michaela M. White, Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors, 7 Am. Bankr. Inst. L. Rev. 27, 31 (1999) (finding that under 1998 version of legislation, means testing would force 3.6% of sample Chapter 7 debtors to pay something); see also Teresa A. Sullivan et al., As We Forgive Our Debtors 239-40 (1989) (noting that Chapter 13 debtors are not better off financially and have the same high debt-to-income ratios as Chapter 7 debtors, so that the two chapters are not sorting debtors according to who can and cannot pay).
catching the system's abusers without excluding many "honest but unfortunate" debtors in the process. Furthermore, because many debtors are already undertaking repayment in Chapter 7 or Chapter 13, there is less room for additional repayment of old debt in bankruptcy than is commonly assumed. With only modest gains possible in catching abusers and increasing collections in bankruptcy, it is particularly appropriate to ask whether any given proposal for reform will do more harm than good, imposing new costs for minimal returns. We should be asking: would the proposed changes make for a better system than we currently have?

The pending consumer bankruptcy legislation fails this test. It would make access to bankruptcy more difficult for all, imposing new costs and hurdles and thus pricing the worst off out of the system. Currently, Chapter 7 works reasonably well to give

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5. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
6. Repayment in Chapter 7 can occur under a formal reaffirmation agreement or more informally, through court-protected ride-through or creditor acquiescence, with the creditor declining to repossess collateral so long as the debtor pays. See Marianne B. Culhane & Michaela M. White, Debt After Discharge: An Empirical Study of Reaffirmation, 73 AM. BANKR. L.J. 709 720, 730 (1999) (finding reaffirmation occurred in twenty-five of weighted sample of Chapter 7 cases, much of that to undersecured and even completely unsecured creditors); see also id. at 740-41, 745-46 (noting that sixty percent of Chapter 7 debtor sample with homes and perhaps as many as fifty-three percent of the same sample with cars apparently held on to the collateral without reaffirmation, by creditor acquiescence in continued payment or by "ride through" with court protection). In addition, of 1.4 million non-business Chapter 7 and Chapter 13 cases filed in 2001, about 400,000 (or more than twenty-eight percent) were in Chapter 13, where the debtor must propose a repayment plan. Bankruptcy Filings Set Record in 2001, Feb. 19, 2002, at http://www.abiworld.org/release/LATEST.html (last visited Apr. 16, 2002). Thus, adding up the cases in which repayment occurs in Chapter 13, under a plan, and in Chapter 7, whether by reaffirmation, creditor acquiescence, or court-protected ride-through, it seems likely that half or more of consumer cases already involve some repayment. An industry study reported an even higher rate of debtors reaffirming one or more debts, fifty-two percent. See NBRC REPORT, supra note 3, 152 n.320 (concerning the VISA study of 1996).
distressed debtors a fresh start, although the large number of pro se filings in some areas raises a question whether Chapter 7 is already too costly for too many debtors.\footnote{See Culhane & White, Reaffirmation, supra note 6, at 732 (finding that nine percent of debtors in their 1995 sample filed pro se); see also Susan Block-Lieb, A Comparison of Pro Bono Representation Programs for Consumer Debtors, 2 AM. BANKR. INST. L. REV. 37, 40 (noting unavailability of low cost bankruptcy advice); id. at 41 (noting that 7.2% of Chapter 7 cases were filed pro se in 1987; with higher pro se rates in some localities, such as 50% in the Central District of California) (1994); Russell A. Brown, Bankruptcy and the Unauthorized Practice of Law, ARIZ. LAW., Feb. 1999 (reporting nearly half of Chapter 7 cases in Arizona were filed pro se, with the majority of them prepared by document preparers who typically charged $200). Problems with document preparers led to passage of 11 U.S.C. § 110 in 1994 (inter alia, requiring that debtors be supplied with copies of documents, prohibiting use of the term “legal” in advertising, prohibiting collection of court fees, requiring disclosure of fees to the court, authorizing the court to disallow fees, and providing for various penalties for violations of provisions of the section).}

In contrast to Chapter 7, Chapter 13 has long been in trouble. Most Chapter 13 plans are not completed and thus fail to provide the debtor with a discharge.\footnote{See NBRC REPORT, supra note 3, at 90 (noting that the completion rate is thirty-two percent); see also William C. Whitford, The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy, 68 AM. BANKR. L.J. 397, 410-11 (1994) (reporting average completion rate of thirty-one percent, with a majority of Chapter 13 plans not completed in all regions of the country); William C. Whitford, Has the Time Come to Repeal Chapter 13?, 65 IND. L.J. 85, 92-93 (1989) (discussing high failure rate and consequences of plan failure). Some non-completions are not failures from the debtor's point of view but rather involve using Chapter 13 just long enough to pay off arrearages on secured debts.}

Many Chapter 13 plans accomplish little in the way of unsecured debt repayment, at hefty administrative expense.\footnote{See Ed Flynn & Gordon Bermant, Estimating Means-Tested Chapter 13 Case Yields from Current Chapter 13, AM. BANKR. INST. J., June 2000, available at http://abiworld.org/abidata/online/journaltext/00junnumbers.html (last visited Apr. 16, 2002) (noting that the average 1998 yield per Chapter 13 debtor to the debtor's unsecured creditors collectively was $540, or $45 per month). Since most plans are not completed, see supra note 9, those rates of payment are not typically sustained for the length proposed in the plan. Much of debtors' plan payments goes to administrative expenses. See Scott F. Norberg, Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13, 7 AM. BANKR. INST. L. REV. 415, 434-38 (1999) (noting that plan
possible to increase performance in Chapter 13 through good administration,\(^\text{11}\) the proposed legislation ignores the important lesson that a realistic budget is crucial to a successful plan.\(^\text{12}\) Instead, the legislation incorporates stringent IRS collections guidelines on living expenses as the basis for determining ability to pay, even though the IRS has found that its expense guidelines are often not realistic.\(^\text{13}\)

There has been no showing of an increased rate of bankruptcy abuse.\(^\text{14}\) The reason we have had more bankruptcies in recent years is because of a huge growth in consumer debt, particularly among lower income debtors, not because better-off individuals are filing more often in bankruptcy.\(^\text{15}\) Current law's loose means-testing standard ("substantial abuse") causes no trouble for most Chapter 7 cases because the problem of abuse is small.\(^\text{16}\) Practitioners who

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\(^{11}\) See Jean Braucher, A Study of Debtor Education in Bankruptcy: Impact on Chapter 13 Completion Not Shown, 9 AM. BANKR. INST. L. REV. 557, 558-59, 574, 576 (2001) (noting that the Charlotte, N.C. trusteeship attains 55% completion rate, highest in study of five trusteeships, by such strategies as permitting many low percentage plans, requiring pay orders to have the debtor's employer pay the trustee directly and by deferring full payment of the debtor's attorney for three years). Still, even in Charlotte, with a Chapter 13 program that is in many ways exemplary, 45% of debtors are failing to complete their plans.

\(^{12}\) See id. at 565 (stating that a problem with existing debtor education programs is that the education comes too late to be used by the debtor to draw up a realistic budget); see also Jean Braucher, Lawyers and Consumer Bankruptcy: One Code, Many Cultures, 67 AM. BANKR. L.J. 501, 536 (1993) (describing tendency of debtors in Chapter 13 not to budget enough for ordinary expenses and contingencies in order to appear to have enough to pay for collateral such as homes and cars).

\(^{13}\) See infra Part IV.B.2 (concerning use in the legislation's abuse test of stringent IRS collection standards for expenses, standards that are not in fact rigidly applied by the IRS).

\(^{14}\) See infra notes 61-62.

\(^{15}\) See id.

\(^{16}\) See 11 U.S.C. § 707(b) (2000) (providing for dismissal of consumer cases that would be a substantial abuse); see also SULLIVAN ET AL., supra note 4, at 33 (noting that because of relatively low incomes of debtors in bankruptcy, most need not be concerned about substantial abuse challenges); Braucher, Lawyers
do consumer bankruptcy work report that they rarely see a case where there is a risk of a substantial abuse challenge – because debtors typically have little or no income in excess of expenses.\textsuperscript{17}

In place of the current “substantial abuse” standard, the new bankruptcy bill would substitute a complex two-step process of review for abuse. After a strict “presumed abuse” phase of review (which nonetheless incorporates some standards),\textsuperscript{18} debtors who could afford to do so would proceed to a “special circumstances” phase of review, under a reasonableness standard.\textsuperscript{19} New paperwork and other hurdles would be added in all cases. All debtors would have to prepare a complex means-testing calculation.\textsuperscript{20} In addition, every debtor would have to undergo credit counseling before filing (even if it were clear that the debtor could not qualify for a non-bankruptcy repayment plan).\textsuperscript{21} Every debtor would also have to receive education in financial management after filing, as a condition of discharge.\textsuperscript{22} Furthermore, debtors’ attorneys would face new liability for the accuracy of their clients’ representations to them, potentially putting them in the role of investigating their clients.\textsuperscript{23} All these new burdens would make Chapter 7 more cumbersome and thus more expensive and inaccessible. At the same time, the legislation would make Chapter 13 even more burdensome and unworkable than it already is, by requiring repayment for five years and at unrealistic levels for many debtors, thus increasing the failure rate.\textsuperscript{24} A workable consumer bankruptcy system depends upon affordability and, in light of our experience with high failure rates

\textit{and Consumer Bankruptcy, supra} note 13, at 537 (noting that lawyers and Chapter 7 trustees in four cities studied, Dayton and Cincinnati, Ohio, and Austin and San Antonio, Texas, agreed that substantial abuse challenges are rare because debtors rarely have excess income over reasonable expenses).

17. \textit{See id.}

18. \textit{See infra} Part IV.B.2 (concerning the presumed abuse test in the legislation and describing how even the first phase of review in the legislation’s means testing incorporates standards for several types of expenses).


in Chapter 13, realistic repayment expectations.

The predictable effect of making bankruptcy more complicated and expensive would be to deny relief to those with little ability to repay. Debt collectors would be able to squeeze a little more, though rarely full repayment, from debtors denied the protection of the bankruptcy system. Furthermore, this increase in collections at the margin would likely lead to yet more expansion of the high-risk, high-cost credit market, increasing the social problem of over-indebtedness.\(^{25}\)

Certainly improvements in consumer bankruptcy law could be made. The system needs simplification, and realistic means testing, targeted at those who could pay, might be achievable in a simpler system. Systems in other countries, such as Canada and Australia, offer possible workable models for demanding repayment out of surplus income from the small number of abusers who currently slip through. When repayment is required in these countries, at most half of the surplus over an income threshold must be contributed, providing a cushion for expense variations.\(^{26}\)

Part I of this Article discusses the success of current Chapter 7 and the failure of current Chapter 13. Part II reviews the evidence that recent increases in filing rates are not caused by increased abuse but rather by more consumer debt, particularly among lower income persons. Part III explains why bankruptcy reform that reduces access to the discharge is unlikely to reduce the filing rate, but rather will increase the volume of consumer debt and thus the problem of over-indebtedness. Part IV describes current and proposed means testing. Finally, Part V discusses the need for the simplification of consumer bankruptcy law and explains how means testing could be incorporated into a simplified system.

I. THE SUCCESS OF CHAPTER 7 AND FAILURE OF CHAPTER 13

Chapter 7 has been a remarkably cheap and effective consumer remedy. It is a simple administrative action that rarely involves litigation or special pleading. Perfect individualized

\(^{25}\) See infra Part III.

\(^{26}\) See infra Part V (discussing the idea of a single portal to consumer bankruptcy and some features of Canadian and Australian means testing).
justice is not achieved, but rough justice at an affordable price is.\textsuperscript{27} Indeed, bankruptcy law is one of the few areas of consumer law that works reasonably well to meet consumer needs.\textsuperscript{28}

To get a discharge, a consumer files a Chapter 7 petition, along with the required schedules of assets, liabilities, income and expenses.\textsuperscript{29} A bankruptcy trustee, who is usually paid $60 per case,\textsuperscript{30} calls a "first meeting of creditors," but typically no creditor attends.\textsuperscript{31} The trustee goes over the debtor's schedules and may ask a few questions. In theory, the "liquidation" phase of the bankruptcy comes next, but in more than ninety-five percent of consumer cases the debtor has no non-exempt assets to liquidate.\textsuperscript{32} There may be a discharge hearing before a judge, but more commonly the discharge arrives in the mail.\textsuperscript{33} Usually no one—not the trustee, the judge or any creditor—challenges the use of Chapter 7 or the discharge of any debt, and the debtor gets relief

\textsuperscript{27} See Whitford, Individualized Justice, supra note 9, at 397-98 (describing the problem of achieving individualized justice when small amounts are at stake and hiring lawyers at normal rates is impractical).

\textsuperscript{28} See Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 504-05 (noting that consumer bankruptcy is a strikingly usable consumer remedy, which lawyers advertise to provide, in contrast to lawyer avoidance of many other forms of consumer representation); see also Edward L. Rubin, The Code, the Consumer and the Institutional Structure of the Common Law, 75 WASH. U. L. Q. 11, 32-36 (1997) (discussing how remedies that require litigation are ill-suited for use by consumers).

\textsuperscript{29} See 11 U.S.C. § 301 (2000) (regarding voluntary filing); see also id. § 521(a) (concerning debtor's duties to file a list of creditors and schedules of assets and liabilities and income and expenditures).

\textsuperscript{30} See id. § 330(b) (providing for a Chapter 7 trustee fee of $45 plus $15 in a no-asset case). Percentage fees depend upon disbursements to creditors. Id. § 326(a). More than 95% of consumer cases are no-asset, so that there is no liquidation and disbursement. See supra note 3 and accompanying text.

\textsuperscript{31} See 11 U.S.C. § 341; Teresa A. Sullivan et al., The Fragile Middle Class: Americans in Debt 13 (2000) (explaining that few creditors bother to attend the § 341 meeting).

\textsuperscript{32} See supra note 3 and accompanying text.

\textsuperscript{33} See Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors: Text, Cases and Problems 243 (2001) (noting that most courts have dispensed with the requirement that the debtor appear for a discharge hearing and instead mail the discharge papers on the theory that a struggling debtor should not miss a day of work to attend a ceremony).
without litigation or any real argument.\textsuperscript{34} A lawyer can handle a routine case in several hours, including counseling, document preparation and appearances.\textsuperscript{35} A Chapter 7 consumer debtor typically pays attorney’s fees of less than $1000\textsuperscript{36} and a filing fee of $155.\textsuperscript{37} For this price, the debtor is relieved of a huge burden of unmanageable debt (typically more than the debtor’s annual income).\textsuperscript{38} From filing to discharge, the whole process is usually over in about six months, including waiting time.\textsuperscript{39} The simplicity and resulting affordability of the process depend on most cases being uncontested and not requiring special pleading.

In most cases, the results in Chapter 7 are highly predictable. Apparent uncertainties in the law on the books typically matter little in practice under the law in action. To be sure, there are

\textsuperscript{34} See Eric A. Posner, Should Debtors Be Forced Into Chapter 13?, 32 LOY. L.A. L. REV. 965, 976 (1999) (noting, “Most Chapter 7 cases are not heavily contested.”) and Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 537 (finding that substantial abuse challenges by a judge or trustee are rare); Culhane & White, Reaffirmation, supra note 6, at 736 (noting that creditors filed nondischargeability complaints in two percent of sample Chapter 7 cases, and the large majority of those were settled, often by reaffirmation). Threats to challenge dischargeability are more common, as a means to get reaffirmations. See id. at 736, 750.

\textsuperscript{35} See Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 554 (concerning use of staff to help with document preparation and fact that most lawyers only meet once with client before filing, although a sizeable minority met twice).

\textsuperscript{36} See id. at 516, 547 (reporting that Chapter 7 median fees in four cities as of 1990-1991 ranged from $300-350 to $700-750); see also SULLIVAN ET AL., FRAGILE MIDDLE CLASS, supra note 31, at 11 (estimating fees in Chapter 7 and Chapter 13 at $750 to $1,500 range). Fees are typically higher in Chapter 13 than in the Chapter 7. See Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 546-54. Fees also vary greatly around the country, but fees below $1000 in Chapter 7 remain typical as of this writing.


\textsuperscript{38} See SULLIVAN ET AL., FRAGILE MIDDLE CLASS, supra note 31, at 70-71 (explaining that sample of 1991 debtors typically owed eighteen months worth of income in non-mortgage debt).

\textsuperscript{39} There is no required delay, but one reason discharges typically are not given more quickly is that proofs of claim can be filed within ninety days of the first meeting of creditors, except for governmental creditors, who have 180 days to file a proof of claim. See FED. R. BANKR. P. § 3002(c)(1).
varying approaches taken by different courts or U.S. trustees, but lawyers only have to worry about the approach used in the locality where they practice. Local legal cultures in bankruptcy work according to well-understood rules of thumb. Usually, lawyers do not have to be concerned about a challenge under the "substantial abuse" test. Both debtors' attorneys and Chapter 7 trustees report that they rarely see cases where debtors have income in excess of reasonable expenses. In the occasional case where a debtor has significant income in excess of reasonable expenses, it is easy to avoid controversy by simply filing directly in Chapter 13. The economics of flat fee practice, along with the tendency to acquiesce to local culture, often lead lawyers to avoid aggressive strategies that may draw challenges. Putting debtors into Chapter 13 repayment plans, even though realistically they lack the means to succeed, is now a much more common occurrence in consumer practice than shepherding clients with excess income through Chapter 7.

Despite the efficiency of Chapter 7 as a means of debt relief, its price is already a little high, as evidenced by burgeoning pro se filings, (which are partially supported by the document-
preparation industry). Any changes in Chapter 7 that would make the process more cumbersome would price some of the worst-off out of the system and also further burden the courts with pro se filers.

Chapter 13 has been much less successful than Chapter 7. More than two-thirds of Chapter 13 debtors do not complete their plans and thus do not get a discharge. A leading cause of failure is unrealistic budgeting. Debtors too often fail to include their necessary expenses and stretch to make payments on collateral they cannot really afford, so that their plans do not have a good chance to begin with. In addition, Chapter 13 debtors usually propose plans of three to five years, and economic setbacks over that length of time lead to failures even when the plan is realistic at the outset. Attorneys’ fees in Chapter 13 are generally higher than in Chapter 7, often $1500 or more. Due to the greater complexity of Chapter 13, use of document preparers is even more perilous

46. See id.
47. One of the burdens is the need to oversee reaffirmations for pro se debtors. 11 U.S.C. § 524(d). See NBRC REPORT, supra note 3, at 147 (concerning court monitoring of reaffirmation agreements and proliferation of local rules on the subject).
48. See sources listed supra note 9. Some of these debtors get a discharge by converting to Chapter 7 and others do so by refiling in Chapter 7 or Chapter 13. See NBRC REPORT, supra note 3, at 273-87 (concerning proposal to automatically convert Chapter 13 cases to Chapter 7 rather than dismiss them and discussing the need of many Chapter 13 debtors for repeat access); see also 11 U.S.C. §§ 1328(a)-(b) (2000) (providing that discharge is ordinarily not given until plan completion).
49. See Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 536 (concerning tendency to under-budget for ordinary expenses and contingencies in Chapter 13 in order to stretch to try to hold on to houses and cars); see also Braucher, Counseling Consumer Debtors, supra note 43, at 181-82 (discussing need to budget realistically to determine the feasibility of Chapter 13 and to minimize the risk of substantial abuse challenges in Chapter 7).
50. 11 U.S.C. § 1325(b) (providing that a Chapter 13 debtor who is not paying debts in full must pay disposable income for three years, to avoid risk of confirmation challenge); see also id. § 1322(d) (implementing a statutory five-year maximum length for proposed plans).
51. See Braucher, Debtor Education, supra note 11, at 574 (noting that typical Chapter 13 attorneys fees in three of five cities as of 1994 were $1500 or more).
than in Chapter 7.\textsuperscript{52} Altogether, administrative expenses of Chapter 13 eat up a substantial portion of plan payments, with most of the repayment going to secured creditors who would get paid the value of their collateral in Chapter 7 at any rate.\textsuperscript{53}

Calls for more debtors to use Chapter 13 often seem to be made in ignorance of its high failure rate and low returns to unsecured creditors.\textsuperscript{54} Although there is theoretical appeal to the idea of requiring debtors to use future income to pay off old debt,\textsuperscript{55} experience shows that even when debtors choose to use Chapter 13, without the difficulty that stringent budgeting under IRS expense guidelines would add, they usually do not succeed.\textsuperscript{56} Most debtors in bankruptcy can, at best, just make ends meet, much less pay off old debts. Yet the proposed legislation would make Chapter 13 even more burdensome and thus unrealistic than it already is.\textsuperscript{57}

If the drive for means testing is at least in part about giving similar treatment to the similarly situated, then part of the problem is the number of “can’t pay” debtors who try and fail in Chapter 13. A good percentage of Chapter 13 debtors fall into that

\textsuperscript{52} Nonetheless, pro se filings in Chapter 13 are common in some areas, such as California. See VISA \textit{CONSUMER BANKRUPTCY} 1997 BANKRUPTCY PETITION STUDY (1997), available at http://www.abiworld.org/stats/visa/97debtortables.html (last visited Apr. 19, 2002) (finding that 22.5\% of California Chapter 13 debtors in study filed pro se).

\textsuperscript{53} See Norberg, \textit{supra} note 10, at 434-38.

\textsuperscript{54} See id. Industry-funded researchers claimed that $3 to $5 billion more could be paid to creditors, but an examination of this claim revealed that it would have required forty percent of the Chapter 7 debtors at the time to pay five times as much as the average Chapter 13 debtor was then paying. Flynn \& Bermant, \textit{supra} note 10; see also Posner, \textit{supra} note 34, at 976 (arguing that means-testing legislation is desirable because it makes Chapter 13 “presumptive,” but never mentioning the high failure rate in Chapter 13 currently).


\textsuperscript{56} See NBRC REPORT, \textit{supra} note 3, at 90 (noting that with such a high rate of failure in voluntary Chapter 13, forcing unwilling debtors into that chapter may only burden the system).

\textsuperscript{57} See \textit{infra} Part IV.B.6.
category, as evidenced by the high failure rate. In short, under-use of the fresh start is a much bigger problem than its abuse. But there is no industry lobby working for means testing of Chapter 13, to see that debtors using Chapter 13 have the means to succeed.

II. INCREASED FILINGS: NOT CAUSED BY NEW ABUSE

To the extent there is an idea, as opposed to an industry objective, behind means testing, it is that there is some percentage of debtors who could and should pay something out of current income to their creditors, rather than getting a quick fresh start. This is not a new idea. It was behind the invention of the old Chapter XIII, was raised again during the work of the Bankruptcy Commission of the 1970s, and led to the addition of the substantial abuse test in the 1984 Amendments.

Most people concede that there are some abusers in bankruptcy. The debate has been more about how many. The estimates of how many people would be caught by the new means testing have ranged from low single digits to the industry claim of

58. See supra note 9 and accompanying text.
59. See Iain D. C. Ramsay, Individual Bankruptcy: Preliminary Findings of a Socio-Legal Analysis, 37 OSGOODE HALL L.J. 15, 80 (1999) (noting that bankruptcy policymaking in Canada is not a rational process based on careful socio-legal analysis but is better understood in terms of interest group politics). One might characterize the story in the U.S. as even worse, in that the National Bankruptcy Review Commission did carefully review the available socio-legal literature and analyze it, but then that analysis was ignored in favor of interest group politics.
60. See 11 U.S.C. § 707(b) (2000); see also Walter Chandler, The Wage Earners' Plan: Its Purpose, 15 VAND. L. REV. 169, 170 (1962) (stating that Chapter XIII provides a debtor “an opportunity to meet his just obligations and to look his creditors in the face instead of crossing to the other side of the street in order to avoid them.”); Reginald W. McDuffee, The Wage Earner's Plan in Practice, 15 VAND. L. REV. 173 (1962) (noting that increased use of wage earner plans lessens creditor losses but listing many factors necessary to make repayment plans work); REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, pt. I at 159 (1973) (concluding that forced participation in a plan requiring payment out of future income has too little chance of success to be adopted); NBRC REPORT, supra note 3, at 90 (noting that the credit industry has sought means testing consistently for at least thirty years).
fifteen percent (later revised down to eleven percent). In addition, most of these so-called abusers are not high-income individuals and face very large debt burdens; therefore not everyone would agree that we should bar them all from a fresh start. How poor, indebted and beleaguered by unforeseen circumstances you have to be to qualify as an “honest but unfortunate” debtor is a highly debatable question. Many easy qualifiers were much in the news in late 2001 and early 2002—such as office cleaners, restaurant dishwashers, taxi drivers and hotel banquet servers who did not plan for the economic effects of the September 11 attacks.

Whatever the dimensions of the abuse problem, it is not a new one, and the rate of abuse is not growing. There is good evidence that people filing for bankruptcy today are not better off than those who filed twenty years ago. Rather, more Americans are carrying large debt burdens when they experience financial reverses, leading to more filings; but debtors in bankruptcy today are in the same or worse financial condition as in the past. Furthermore, the other means-testing problem in the bankruptcy system, use of Chapter 13 by people without the means to repay, goes unaddressed. The complexity of the current system obscures this problem.

Supporters of means testing treat the increase in personal bankruptcy filings over the last twenty years as the problem, with
changes in the law to restrict access as the solution. In the late 1990s, the argument for means testing also rested on an assumption of "low unemployment, steady economic growth and general prosperity," to quote Judge Edith Jones and Professor Todd Zywicki in the opening sentence of their 1999 article "It's Time for Means-Testing." One wonders, however, whether the inconvenient fact of an economic recession in 2001-2002 will change these authors' minds or just produce a restatement of their argument that no longer refers to good economic times. At any

65. See Jean Braucher, Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission’s Proposals as a Starting Point, 6 AM. BANKR. INST. L. REV. 1, 4-5 (1998) (quoting Representative George Gekas concerning the increased filing rate as showing a new “bankruptcy of convenience . . . borne out of a loss of stigma”).


67. See David Leonhardt, U.S. Jobless Rate Increases to 6%; Highest in 8 Years, N.Y. TIMES, May 4, 2002, at A1 (reporting on surge in unemployment as of April 2002) and Sarah Kershaw, Failed Mortgages Soar in New York, N.Y. TIMES, Mar. 27, 2002, at A1 (attributing rise in mortgage defaults in the New York area in part to unemployment after September 11); see also Todd J. Zywicki, Bankruptcy Law as Social Legislation, 5 TEX. REV. L. & POL. 393, 431, 412 (2001) (arguing for reform of “promiscuous bankruptcy laws” as part of a moral campaign to reverse the “self-indulgence of the Baby Boomers”). A reduction in stigma associated with bankruptcy is much discussed, although there is precious little hard evidence that it has occurred. Assuming there is less stigma, however, this could be caused by the flood of new credit being made available and resulting over-indebtedness rather than by some deeper moral change. See infra notes 74-79 and the accompanying text. If moral blame is to be assessed for the current bankruptcy rate, at least equal time ought to be given to the behavior of credit issuers. See Laurie A. Lucas, Integrative Social Contracts Theory: Ethical Implications of Marketing Credit Cards to U.S. College Students, 38 AM. BUS. L. J. 413 (2001) (applying integrative social contracts theory to credit card marketing to college students and concluding that use of persuasive strategies and peripheral cues, such as promotional gifts and celebrity endorsements, rather than informational advertising, is approved by credit industry norms but conflicts with broader norms against taking unfair advantage of unsophisticated people). There have been many press reports recently of an increase in filings by young people. See, e.g., Vikki Ortiz, More Debt Laden 20-Somethings Are Seeking Help, MILWAUKEE J. SENTINEL, Dec. 2, 2001, at 01A (quoting lawyers concerned about more debt problems among young people);
rate, bankruptcy law has been permanent since 1898, and it needs to be designed for good times as well as bad.

Another aspect of the case for means testing involves the claim that enactment of the Bankruptcy Code in 1978 represented a liberalization of the law, and this legal change in turn increased bankruptcy filings. In this view, we can solve the problem by restricting access to bankruptcy. It is not at all clear that the 1978 Bankruptcy Code represented a significant liberalization in the law; furthermore, the 1984 Amendments took steps to get tougher and cut back somewhat on access by adding the substantial abuse and disposable income tests. Even assuming a liberalization in fact, however, an obvious problem with the theory that this caused an increase in filings beginning in the 1980s is lack of consumer knowledge of the law. Indeed, more than twenty years later, the

Kristin Tillotson, *Credit Card Debt Is Pushing Youth into Bankruptcy — It's Easy for Teens to Get Credit Cards, But Paying Them Off Can Prove to Be a Financial Nightmare*, STAR TRIB. (Minneapolis, St. Paul), June 3, 2001, at 1A (quoting lawyers and credit counselors as saying that young people are among the fastest growing age group of people opting for bankruptcy). Increased credit availability is a more likely explanation for more filings by the young than moral decay compared to previous generations of young people. See Teresa A. Sullivan et al., *Young, Old and in Between: Who Files for Bankruptcy*, NORTON BANKR. L. ADVISER, Sept. 2001 (finding that the absolute number of filers under twenty-five went up from 1991 to 2001, although as a percentage of all filers, there was a slight decline in this age group).


69. See William T. Vukowich, *Reforming the Bankruptcy Reform Act of 1978: An Alternative Approach*, 71 GEO. L. J. 1129 (1983) (discussing consumer credit industry campaign to tighten up on access to the discharge in response to increase in bankruptcy filings after the code's effective date and questioning industry and press claims at the time that the new law was the cause of the increase in filings).

70. See id. at 1131 (noting that "slight changes" in the 1978 reform legislation "hardly account for the large increase in bankruptcy filings."). The further changes made in 1984, including the substantial abuse test in Chapter 7, 11 U.S.C. § 707(b), and the disposable income test in Chapter 13, 11 U.S.C. § 1325(b), were designed to push more debtors into making significant repayment in Chapter 13. The disposable income test in Chapter 13 had more impact than the substantial abuse test in Chapter 7 and is part of the reason for the high failure rate in Chapter 13. On the other hand, local legal culture that demands high repayment may be even more significant. See Braucher, *Lawyers and Consumer Bankruptcy*, supra note 12.
general public still does not understand the law. Most people think bankruptcy law is harsher than it is, they also mistakenly think that bankruptcy will cut off their access to credit. Many more Americans could benefit from bankruptcy than use it.

The bigger problem with the theory that bankruptcy liberalization caused the increases in filing that have continued for more than twenty years is this: Creditors, who are informed about the law, would not continue to expand the volume of debt in response to legal changes making it easier for debtors to get a discharge. Thus, a much more plausible explanation for increased lending and resulting growth in bankruptcy filings is interest rate deregulation. In 1978, the same year that Congress enacted the Bankruptcy Code, the Supreme Court decided Marquette National Bank of Minneapolis v. First Omaha Service Corp. This decision effectively deregulated consumer credit interest rates by interpreting a hundred-year-old statute to permit a national bank to charge the interest rates permitted in the state where it is located and to export those rates to customers to other states.

71. See National Consumers League, Survey Shows Confusion on Current Bankruptcy Laws (June 17, 1997), at http://nclnet.org/bankrupt.htm (last visited Apr. 17, 2002) (finding that two-thirds of Americans believe that most people must repay a portion of their debts under the current system). While it may be true that most debtors attempt to pay part of their debts, see supra note 6 and accompanying text, they are not required to do so. See Michelle J. White, Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change, 65 U. CHI. L. REV. 685 (1998) (finding that many more people could benefit from bankruptcy than are using the system, specifically that a majority of U.S. households would benefit financially if they engaged in some pre-bankruptcy planning before filing and comparing this to an actual filing rate of eight percent of households in the previous decade).

72. See Braucher, Counseling Consumer Debtors, supra note 43, at 187 (concerning availability of "second-chance" credit after bankruptcy).

73. See generally White, supra note 71, at 685.


75. Marquette Nat'l Bank of Minneapolis v. First Omaha Serv. Corp., 439 U.S. 299 (1978) (interpreting the National Bank Act to permit national banks to charge the interest rates permitted in states where they are located and to export those rates to customers in states with lower usury limits).

76. See James J. White, The Usury Trompe L'Oeil, 51 S.C. L. REV. 445
National banks responded to the decision by putting in place subsidiaries in locations with favorable rate regulation or none at all (Citibank in South Dakota, and MBNA in Delaware, for example).\(^7\) They proceeded to expand consumer credit volume dramatically, particularly to low-income persons who previously had no access.\(^8\) Not surprisingly, more debt led to more bankruptcy.\(^9\) I do not advocate a return to rate regulation, but it is important to understand that rate deregulation caused more lending, particularly more high-risk lending, and this in turn led to more default and more bankruptcy. If creditors do not like the larger numbers of bankruptcy filings, they could adjust their underwriting and extend less credit to high-risk debtors. But they would prefer to persuade Congress to cut back on bankruptcy access so that they can continue to expand volume into ever more risky sectors.

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\(^8\) See id. (analyzing how greater lending to lower income persons, with greater propensity to borrow more for current consumption, even at high interest rates, led to increased credit problems and personal bankruptcy); see also Sullivan et al., Fragile Middle Class, supra note 31, at 61-63 (noting that in sample of 1991 debtors in bankruptcy, their median income was less than half the national median family income; there were virtually no debtors with income above $75,000; a third of the debtors were in poverty, two and a half times the national poverty rate).

\(^9\) See id.; see also Robert M. Lawless, The Relationship Between Non Business Bankruptcy Filings and Various Basic Measures of Consumer Debt, at http://www/law.missouri.edu/lawless/bus_bkr/body_filings.htm (Version 1.1, last modified July 18, 2001) (noting that nonbusiness bankruptcy filings have a close relationship to consumer debt measurements, so that as consumer debt increases, so do the number of filings); Lawrence Ausubel, Credit Card Defaults, Credit Card Profits, and Bankruptcy, 71 Am. Bankr. L.J. 249 (1997) (discussing how the relaxation of credit standards led to increases in lending to marginal consumers and resulting higher default and bankruptcy rates).
III. LIKELY IMPACT OF REDUCED ACCESS TO BANKRUPTCY: MORE INDEBTEDNESS

What would be the effect of changing the law to cut back on access to bankruptcy? After a transition period of a few years,80 we would expect credit volume to expand more than it otherwise would, as creditors took advantage of restricted access to bankruptcy. Creditors would relax credit standards further, relying on the ability of debt collectors to squeeze a little more out of debtors no longer protected by the automatic stay and then discharge in bankruptcy.81 Lack of access to bankruptcy does not mean that distressed debtors would necessarily pay in full, but it would allow creditors to collect a little more from their marginal customers. So-called "can't pay" debtors can usually pay something if enough pressure is applied. At the end of an adjustment period to the new law, we would likely end up with more over-indebted consumers, more defaults, and, as the result of the expansion of consumer debt, possibly even more filings in bankruptcy. Consumer creditors would get to continue to expand their businesses and might also get a higher rate of return because

80. Initially, there would be a huge increase in bankruptcy filings in the period between enactment and the effective date of the new legislation. We saw a preview of this phenomenon early in 2001, when enactment looked likely and lawyers in some areas advertised the need to act fast. See, e.g., Guy T. Baehr, Personal Bankruptcies Surge in N.J.—Consumers Rush to File as Congress Irons Out Bill, NEWARK STAR-LEDGER, May 11, 2001 (quoting a veteran corporate bankruptcy attorney to the effect that some attorneys had been advertising for clients with warnings that new law could make it harder to get discharge). After enactment, there might be a period of reduced filing. A twenty-something staffer of Representative George Gekas explained to me several years ago that the legislation would work to reduce filings because "perception is reality." Media stories about the new means-testing in the legislation might deter some people from approaching lawyers. Lawyers would initially be off-stride, trying to figure out what the law requires, and some would stop doing bankruptcy work, while others would probably end up raising their fees due to increased paperwork and potential liability. Higher fees would reduce filings, at least initially. It is hard to know to what extent the pre-effective date increase in filings would offset the post-effective date decrease in filings. Eventually, at least some of the demand likely would be met with non-lawyer preparers and more pro se cases.

81. See Braucher, Increasing Uniformity, supra note 65, at 8 ("The message to creditors would be to crank up the volume of consumer debt even more.").
of the increased collections at the margin. The opportunity to expand volume and increase profits is presumably why the credit industry has expended millions promoting the bankruptcy legislation. Of course they want this opportunity, but the question for the rest of us is whether what is good for Citibank and MBNA is also good for America. The crucial point is that restricting access to bankruptcy is unlikely to reduce lending, default or perhaps even the number of bankruptcies.

Douglas Baird, then dean of the University of Chicago School of Law, reached a similar conclusion that it is unlikely that the legislation would reduce the number of filings in the long run. He wrote:

Advocates of the bills suggest that these changes will reduce the number of bankruptcy filings, of which there are now more than a million per year. Bankruptcy filings, however, are affected

82. Whether creditors would get a higher rate of return from constricting access to bankruptcy depends on whether creditors would be forced by competition to return all of their collection gains to their customers in the form of lower interest rates. The stickiness of consumer credit interest rates in the 1980s and into the 1990s, despite reductions in the cost of funds, drew the attention of economists and government regulators. See U.S. CREDIT CARD INDUSTRY — COMPETITIVE DEVELOPMENTS NEED TO BE CLOSELY MONITORED, GAO REPORT, Apr. 1994, at 3-6 (discussing alternative theories for stable credit card interest rates despite wide fluctuations in the cost of funds and concluding that the industry should be closely monitored); see also Lawrence M. Ausubel, The Failure of Competition in the Credit Card Market, 81 AM. ECO. REV. 50 (1991). If the proposed bankruptcy legislation were to pass, it seems likely that creditors would capture some of the gains in increased collections in the form of greater profits. The credit industry has developed methods such as “teaser rates” that may take advantage of consumer underestimation of their future borrowing. See Ausubel, Credit Card Defaults, supra note 79, at 261-63. The spread between post-introductory rates and cost of funds remains substantial, and late-payment and overlimit fees, often hidden in the sense that disclosures are ineffective, are another source of profits, so that introductory rates alone are not a good gauge of either profitability or real competitiveness in the industry. See id. at 263.

most by the amount of debt individuals carry relative to their annual income. The higher this ratio, the more likely individuals will be unable to pay their debts if they encounter economic misfortune. These changes, by making bankruptcy less attractive, may make people less inclined to borrow. Everything else being equal, this will tend to reduce the number of defaults and the number of bankruptcy filings. But these same changes will also make lenders more likely to extend credit. They will lend more money and thus increase the ratio of debt to annual income, the number of defaults, and the number of bankruptcy filings. Unless there is some reason to think that the first effect will dominate the second (and there is not), a policy maker who wants to reduce the number of bankruptcy filings should hesitate before supporting this legislation.84

Baird seems to suggest that the two effects, on debtors and on creditors, might cancel each other out. But there are good reasons to think that bankruptcy restrictions have more impact on creditors' decisions to lend than on debtors' decisions to borrow. Creditors invest in full information about applicable law (and in getting advantageous laws passed), while debtors do not. Furthermore, rate deregulation has made high-risk lending profitable, and high-risk debtors have a higher propensity to borrow despite the high cost.85 They finance current consumption out of a felt need.86

Economic analysis works particularly well as a means to understand the incentives that drive financial institutions. These institutions fit the "rational actor" assumption of economic theory much better than do individuals, who are more bounded in their knowledge and will-power.87 This is why restricting access to the

84. See Douglas Baird, Bankruptcy's Uncontested Axioms, 108 YALE L. J. 573, 575 n.7 (1998) [citations omitted].
85. See Ellis, supra note 77, at 9.
86. See id. (noting that this behavior could be characterized as either irrational or as based on a rational calculation to take the risk that future income will allow them to repay).
87. See Cass Sunstein et al., A Behavioral Approach to Law and Economics, in Cass Sunstein, Behavioral Law and Economics 14-16 (2000) (discussing bounded rationality, bounded will power and bounded self-interest as problems with standard law and economics assumptions); see also Russell V.
individual bankruptcy system is unlikely to reduce the number of bankruptcy filings in the long run.

Thus, with creditors encouraged to lend more under the proposed legislation, we would likely end up with more consumer debt and more consumer over-indebtedness, a phenomenon that is broader than bankruptcy. By over-indebtedness, I do not mean anything technical, but simply difficulty handling one's debts, with attendant negative social and psychological effects. More people seek credit counseling each year than file in bankruptcy, and not

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88. Judging by reactions I have heard from several advance readers to my use of the phrase “over-indebtedness,” American scholars seem to have trouble with this rather ordinary concept, one that is a commonplace among European scholars and policymakers. See Nick Huls, OVERINDEBTEDNESS OF CONSUMERS IN THE EC MEMBER STATES: FACTS AND SEARCH FOR SOLUTIONS 204-10 (1994) (discussing social and psychological consequences of difficulty with repayment, including destructive effects on family life, and contrasting European tendency to view over-indebtedness as a societal problem to American views emphasizing individualism and an economic approach). A largely unexplored dimension of American over-indebtedness is its social and psychological effects. But see Press Release, Myvesta.org, Myvesta.org Survey (Nov. 29, 2001) (available on file with the Fordham Journal of Corporate & Financial Law) (concerning greater signs of stress and depression among persons with debt problems). For more discussion of over-indebtedness research and theory in Europe, see Gianni Betti et al., Study of the Problem of Consumer Indebtedness: Statistical Aspects (OCR Macro Oct. 2001), available at http://europa.eu.int/comm/consumers/policy/developments/fina_serv/fina_serv06_en.pdf (last visited May 5, 2002). This study notes that over-indebtedness is defined in different ways in different studies and in different European countries, including in objective, subjective and administrative ways (according to some event of default, perceived difficulty by debtors, or resort to official action, including court action). Id. at 40-41.

89. See NFCC FACT SHEET, Nov. 1, 2000, available at http://www.nfcc.org/news/showness.cfm?newsid=64 (last visited Apr. 16, 2002) (reporting that members of National Foundation for Credit Counseling, organization of nonprofit consumer credit counseling agencies, counseled 1.6 million families in 1999); see also Richard L. Stehl, The Failings of the Credit Counseling and Debtor Education Requirements of the Proposed Consumer
everyone who struggles with debt seeks either credit counseling or bankruptcy. A socio-legal perspective on bankruptcy tends to see it not as the problem but as a symptom of a broader social problem, over-indebtedness.

Over-indebtedness results from a combination of factors, including carrying a high debt burden in relation to income, lack of savings, and insecurities in financial status that can cause unanticipated loss of income or sudden increases in expenses. Job loss in the United States is increasingly attended by lack of unemployment compensation (and even when the employee receives compensation, it is less than the individual's previous income).90 Millions lack health insurance, and others rack up medical bills that exceed insurance coverage or switch to less demanding jobs after suffering an illness or injury, thus losing income.91 Family break-up92 can suddenly increase expenses as two households replace one, on the same income. People who are carrying large amounts of debt are less able to withstand the shock of a loss of income or sudden increase in expenses. Never before have so many people carried such large debt burdens, and as a result more people become over-indebted.93 Indeed, a significant portion of the population is probably continuously at significant

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90. See A. Mechele Dickerson, America's Uneasy Relationship with the Working Poor, 51 HASTINGS L.J. 17 (1999) (comparing debates over welfare reform and bankruptcy reform, particularly the obsession with “cheats” and “abusers,” compared to much less focus on lack of job and educational skills of the poor).

91. See Melissa B. Jacoby et al., Rethinking the Debates over Health Care Financing: Evidence from the Bankruptcy Courts, 76 N.Y.U. L. REV. 375, 377-78 (2001) (finding that nearly half of all bankruptcies involve a medical problem, but not just due to lack of any insurance; medical bills in excess of coverage and job shifts caused by medical problems also contribute to debt problem after illness or injury).

92. See SULLIVAN ET AL., FRAGILE MIDDLE CLASS, supra note 31, at 181 (stating that more than fifteen percent of sampled debtors identified marital disruption as a source of their financial troubles).

93. See generally Ellis, supra note 77.
risk for difficulty with debt, due to declines in savings and increases in borrowing. A “democratization of credit,” to use the phrase of the consumer credit industry, has occurred since 1978, and it is a new social phenomenon causing new problems. A quick fix in the form of bankruptcy law “reform” will not magically produce more financial planning and prudence or less economic distress and risky borrowing. Borrowing for current consumption is not a recipe for financial security, and this insight was the origin of ancient strictures against usury. Since we have largely given up on supply

94. One of the best hedges against debt problems is savings. The personal savings rate declined ten percent from 1983 to 2000, as borrowing increased. See Richard Peach & Charles Steindel, A Nation of Spendthrifts? An Analysis of Trends in Personal and Gross Saving, 6 CURRENT ISSUES ECON. & FIN. Sept. 2000, at 1 (arguing that negative personal savings rate in 1999 was less symptomatic of bubble economy fueled by reckless consumer spending than might be supposed, because capital gains are excluded from the standard measure of personal savings, but adding, “[s]ince the overwhelming bulk of capital gains accrue to a thin stratum of households, it is possible that favorable developments for a few people are masking troubling trends for the larger population,” and finding comfort in the fact that overall consumer spending was growing no more rapidly than wages and salaries but also noting that we lack the individual household data necessary to assess the soundness of household finances definitively). Of course, in retrospect, we were in a bubble economy in 1999.

95. Because over-indebtedness is such a complex phenomenon, many solutions would be necessary to address it. The financial literacy movement is one response. See Lois A. Vitt et al., Personal Finance and the Rush to Competence: Financial Literacy Education in the U.S., Institute for Socio-Financial Studies Study, Commissioned and Supported by the Fannie Mae Foundation (2000) (reporting that most programs started only recently). But financial literacy can only go so far to reduce over-indebtedness. See Michele Dickerson, Can Shame, Guilt or Stigma Be Taught? Why Credit-Focused Debtor Education May Not Work, 32 Loy. L.A. L. Rev. 945, 958-59 (1999) (noting that “debtor education programs do little for debtors who become economically disabled because they lack marketable job skills, health insurance or are not receiving timely child support payments”).

96. See James M. Ackerman, Interest Rates and the Law: A History of Usury, 27 Ariz. St. U. L. Rev. 61 (1981) (tracing the history of usury restrictions to ancient cultures and recounting the story of the gradual acceptance of lending at interest for productive purposes such as farming and then trade and only much later acceptance of high rates of interest for lending for consumer consumption); see also Lynn Drysdale & Kathleen E. Keest, The Two-Tiered Consumer
side constraints on consumer credit in recent years, we face the long-term task of changing demand, assuming we are interested in reducing over-indebtedness at all.97

IV. CURRENT AND PROPOSED MEANS TESTING

No system can catch every abuser, and our current system already screens out most potential abuse. The means chosen for means testing should not burden "can't pay" debtors with costs they cannot afford, barring them from the relief bankruptcy is intended to provide. Reform could improve our bankruptcy system, but the proposals that have been made are not well designed. They would burden even the worst off, while leaving some inequities and potential abuse in place, and risk bringing the system to its knees with new, often pointless paperwork.

A. Current Repayment and Means Testing

Two features of our current system limit the gains in repayment that means-testing reform can achieve. One is that most Chapter 7 debtors do not get a pure fresh start now. They pay some of their old debt, either with formal reaffirmations, by "ride through" with court protection, or simply because of informal acquiescence by creditors.98 Thus, many Chapter 7 debtors already

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Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking about the Role of Usury Laws in Today's Society, 51 S.C. L. REV. 589 (2000) (describing traps debtors fall into with auto-title pawn loans and payday loans, among other newer forms of consumer credit, and noting that the high cost of consumption using these kinds of credit makes fringe borrowers' attempts to improve their economic status like "trying to go up a descending escalator").

97. One might see over-indebtedness as a mass psycho-social or moral problem, or simply as a change in norms. See Carol Ann Curnock, Insolvency Counselling—Innovation Based on the Fourteenth Century, 37 OSGOODE HALL L.J. 387, 394 (arguing, in the context of a critique of the premises of the Canadian requirement of counseling for consumer debtors, for the need to "ask what differentiates a 'psycho-social problem' from a norm").

98. See Culhane & White, Reaffirmation, supra note 6 (concerning repayment in Chapter 7); NBRC REPORT, supra note 3, at 167-68 (noting that
get what Professor William Whitford has called a "stale start." Furthermore, we should recognize that some sifting of potential abusers from can't pay debtors is already going on. For these reasons, means-testing reform can at most achieve only fine tuning rather than major gains in catching the unworthy and making them undertake a repayment plan if they want a discharge. For marginal gains, it makes no sense to impose huge new burdens and costs.

There is already a provision for dismissal under Section 707(b) for "substantial abuse." This provision, added by the 1984 Amendments to the Bankruptcy Code, avoids any specific means test. Many courts have interpreted it to bar debtors from Chapter 7 if they could pay a substantial amount of their unsecured debt in Chapter 13. This provision has not proved burdensome in practice. Although there are variations in how different courts interpret the test, local practitioners only have to worry about local decisions, greatly reducing the uncertainty that is experienced in practice. Furthermore, attorneys in flat fee practice avoid uncertainty by steering far clear of gray areas.

Under current law, only a U.S. trustee or judge can bring a substantial abuse challenge. Many U.S. trustees run all Chapter 7 cases through a check for substantial abuse using a rule of thumb. For example, cases might get close scrutiny if the debtor's schedules show that the debtor could pay fifty percent of unsecured debt in a three-year Chapter 13. This sort of test takes into account that currently debtors in consumer bankruptcy are prone to understatement of their expenses. If more of them had a better ride-through is the norm for home mortgage obligations in Chapter 7).

101. See In re Kelly, 841 F.2d 908 (9th Cir. 1988); see also In re Walton, 866 F.2d 981 (8th Cir. 1989).
102. See generally Braucher, Lawyers and Consumer Bankruptcy, supra note 12.
104. See Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 536; see also Braucher, Debtor Education, supra note 11, at 574.
grip on their budgets, they might not be in bankruptcy to begin with. Also contributing to the problem of inaccurate schedules is the minimal amount of time counsel put into cases done for small flat-fees. Attorneys learn quickly what sort of disposable income shown by schedules will easily pass U.S. trustee scrutiny and have no trouble getting most of their clients past the applicable screen. If we really had many debtors trying to discharge debts despite ability to pay them, the substantial abuse test could be mobilized; but the evidence is that it is little used because there is little abuse.

Another check on abuse is the fact that debtors lose nonexempt assets in Chapter 7. This feature of Chapter 7 works as a proxy for means testing, in that most people with means for a significant period, accumulate nonexempt assets (for example, savings and investments in a stock portfolio) and have that incentive to avoid Chapter 7. They also have an incentive to avoid Chapter 13. Section 1325(a)(4) requires debtors to pay at least the value of their nonexempt assets in Chapter 13, and they must pay their disposable income after reasonably necessary expenses under Section 1325(b) to avoid confirmation challenges.

Exemptions are more generous in some states than in others, so the incorporation of state exemption law into federal bankruptcy law inevitably leads to a lack of uniformity nationally. Most states have opted out of the federal bankruptcy exemptions, so that only the state exemptions are available. A handful of states permit an unlimited homestead exemption, permitting a few

106. See supra Culhane & White, Means Testing, supra note 4, at 31; see also supra notes 42, 61-62 and accompanying text.
107. See supra note 2.
109. Id. § 1325(b).
110. See Braucher, Increasing Uniformity in Consumer Bankruptcy, supra note 65, at 15.
111. See 11 U.S.C. § 522(b)(1) (authorizing states to opt out of federal bankruptcy exemptions, so that only state exemptions are available); see also NBRC REPORT, supra note 3, at 299-301 (listing thirty-three states as having opted out).
high-end debtors a year to shelter large homes in these states (the palace in Dallas). The Senate version of the proposed legislation would have capped the homestead exemption at $125,000, and remarkably, this cap was controversial; a conference committee eliminated it except for certain debtors, such as convicted felons and violators of securities laws, and also approved a bar on use of a state's homestead exemption for debtors who have moved there within forty months. Still, under the conference committee approach, some debtors would be able to make use of an unlimited homestead exemption in bankruptcy. It is hard to take seriously the idea that the purpose of reform is to stamp out abuse if some high-end debtors get to shelter millions of dollars in a homestead. This is largely a symbolic issue, in that most debtors in bankruptcy with a home have little or no home equity.

**B. Provisions of the Proposed Legislation**

This examination of the provisions of the proposed legislation will focus on demonstrating that they are complex and confusing and would burden even those debtors most in need of a fresh start, without catching all abuse.

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112. See id. (showing five states as having unlimited homestead exemption, Florida, Iowa, Kansas, South Dakota and Texas.)

113. See Philip Shenon, Congress Panel Agrees to Limited Home Shield in Bankruptcy, N.Y. TIMES, Apr. 24, 2002, at C1 (reporting that a conference committee removed the general $125,000 homestead cap from the legislation but retained it for some debtors, such as convicted felons or those with debts under federal or state securities law, and also barred use of a homestead exemption by anyone who had not lived in a state for at least forty months). This compromise thus left in place use of unlimited state homestead exemptions for debtors not in specified categories and who had not moved in forty months. The provision concerning those with debts for securities law liability seemed intended to deal with the possibility that a spate of former Enron executives might file for bankruptcy in Texas and attempt to take advantage of the state's unlimited homestead exemption, something they might still be able to accomplish before the effective date of the legislation, assuming it passes.

114. See SULLIVAN ET AL., FRAGILE MIDDLE CLASS, supra note 31, at 221 (finding in sample of 1991 debtors in bankruptcy with homes had a median home equity of $5500, with one quarter having no equity at all, compared to median home equity of American homeowners generally as of that time of $43,078).
1. No Threshold Median Income Test

An earlier version of the proposed legislation would have excused debtors below the national median income from the need to undergo more detailed means testing. 115 This salutary provision, from the perspective of workability, was eliminated from the legislation in 1998. 116 With a million or more debtors filing in Chapter 7 a year, a quick, simple screen is needed to eliminate all but the most likely candidates for repayment. 117 The 2001 version of the legislation would bring in a state median income test only after the means-testing calculation is prepared, at the tail end of the process, to determine whether creditors, in addition to judges and trustees, could bring abuse challenges and also to determine who is subject to a presumed abuse challenge. 118

Every debtor would have to submit "a statement of the amount of monthly net income, itemized to show how the amount is calculated." 119 A failure to do so would trigger automatic

117. See Culhane & White, Means Testing, supra note 4, at 35 (arguing that any means test needs a mechanism to quickly and simply free the can’t-pay majority to make a fresh start).
118. Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 102 (July 17, 2001). In April 2002, a conference committee resolved the differences between the House and Senate versions of the legislation concerning the homestead exemption. See Shenon, Congress Panel Agrees to Limited Home Shield in Bankruptcy, supra note 113. Agreement had not been reached as of early May on language to bar discharge of liability for abortion clinic violence. See id.; see also Pro-Life Protesters’ Misuse of Bankruptcy Laws, WALL ST. J., May 10, 2002, at A11 (listing, in a letter to the editor from U.S. Senator Charles E. Schumer, instances of use of bankruptcy by radical anti-abortion activists, including Randall Terry and Rev. Robert Behn and Bonnie Benn, in order to escape judgments and fines).
119. S. 420 § 315. This provision is qualified by the phrase “unless the court orders otherwise,” but this does not provide a practical means to relieve below-median income debtors of the need to submit the calculation; they would have to pay for a court appearance to get a court order allowing them not to submit the calculation.
Thus, no debtor would be spared the need to make and submit a means-testing calculation.

2. Abuse and Presumed Abuse

The proposed legislation would reduce the test for dismissal under Section 707(b) from "substantial abuse" to "abuse," generally indicating an intention to get tougher. It also would permit creditors to bring abuse challenges if the debtor exceeds state median income. In addition, abuse would be presumed if "current monthly income," reduced by certain expense amounts, and multiplied by sixty is not less than the lesser of (a) twenty-five percent of unsecured claims or $6000, whichever is greater, or (b) $10,000. A debtor who had $100 in net monthly income (income in excess of permitted expenses) would thus be a presumed abuser.

The expenses permitted to a debtor for purposes of the means-testing calculation would include:

(a) expenses under IRS National and Local Standards for housing, transportation, and food and clothing. The IRS standards were developed as guidelines for tax collection and are not in fact rigidly applied in that context. One of the reasons they are not rigidly applied is that there is a general recognition that in many cases people cannot live on them. Revealing a lack of confidence in the

120. Id. § 316.
121. Id. § 102.
122. See id. Under current law, only U.S. trustees and judges may bring substantial abuse challenges. 11 U.S.C. § 707(b).
123. The $10,000 test makes a presumed abuser of anyone who could pay about $170 per month, even though that would be less than 25% of the debtor's unsecured debt.
124. See Jack Williams, Ruminating on the Proposed Bankruptcy Bill, 20 AM. BANKR. INST. J., July/Aug. 2001, at 6; see also Gary Klein, Impact of Pending Bankruptcy Legislation on Low-Income Debtors, 19 AM. BANKR. INST. J. 34, 35 (2000) (noting that the IRS developed its standards to serve as discretionary guides rather than absolute requirements and that the guides are subject to multiple exceptions, rendering them inappropriate for a statutory test) Because they are so stringent, application of the IRS standards would create a need to prove higher expenses in many cases under the special circumstances phase of
wisdom of using the IRS standards in bankruptcy, the legislation includes a provision directing the Executive Office for United States Trustees to study and submit a report to Congress on the expenses of debtors under section 707(b), as amended, and the impact of the standards on debtors and the bankruptcy courts. It might have been advisable to do a study of the suitability of the IRS standards before drafting the legislation to incorporate them;

(b) actual expenses in categories listed by the IRS standards as "other necessary expenses;"

(c) an additional five percent of the IRS food and clothing standards if reasonable and necessary;

(d) actual reasonable and necessary expenses for an elderly or disabled household member;

(e) "actual" administrative expenses of a hypothetical Chapter 13 case for the debtor. The legislation directs the Executive Office for the United States Trustees to issue schedules concerning these expenses for each judicial district of the U.S.;

(f) actual reasonable and necessary private school expenses up to $1500 per year per child;

(g) actual reasonable and necessary expenses for home energy costs in excess of IRS local standards;

(h) amounts due to secured creditors for sixty months after the petition date, plus additional

review, see infra Part IV.B.4 (noting that debtors would have practical difficulty making this proof because of the added expense).

125. S. 420 § 103(b).
126. Id. § 107.
amounts necessary to retain a residence, motor
vehicle or other necessary property in a Chapter 13
(this is a reference to arrearage payments). The
total is divided by sixty for the calculation;

(i) priority claim amounts, such as child support and
tax obligations. Again, the total amount due is
divided by sixty months for the calculation.

It is noteworthy that many of these expenses would call for
court review — either of how much the actual expense is or
whether it is reasonable and necessary. Thus, "reasonableness"
would come into play even during the first phase of the means-
testing process. The presumed abuse test is not something that
could be applied mechanically.

3. "Current Monthly Income"

For purposes of the presumed abuse test, "current monthly
income" is not actual current monthly income. Rather, it is an
average of the last six months' income received by the debtor and,
in a joint case, the debtor's spouse.\textsuperscript{127} This would have some odd
effects for debtors whose income either went up or down but
would not continue to fluctuate. In many cases, the look-back
approach would not accurately indicate future ability to pay.

Debtors also would be required to report "any reasonably
anticipated increase" in income for the next twelve months,\textsuperscript{128}
although this is not taken into account in the presumed abuse test
but could be the basis for an abuse challenge without the
presumption. What should be "reasonably anticipated" is yet
another interpretation question.

4. Rebuttal of Presumption

In a second phase of review, a debtor could rebut a
presumption of abuse by showing "special circumstances" that
"justify additional expenses or adjustment of current monthly

\textsuperscript{127} Id. § 102.
\textsuperscript{128} Id. § 315.
income for which there is no reasonable alternative." Thus, the first strict phase of review could be followed by a second phase in which individual circumstances and the reasonableness of expenses and the amount of actual income would be considered. This two-step process would put a burden on many debtors to engage in special pleading. A body of case law, probably varying around the country, could be expected to develop concerning when "presumed abusers" can proceed in Chapter 7 due to special circumstances, but debtors would still have to prepare the means-testing calculation under first stage review process to get to the second stage and attempt to overcome a finding of presumed abuse. The realities of low, flat fee practice are that lawyers are quick to avoid the need for special showings with uncertain results. Thus, under the legislation, one would expect to see more lawyers putting marginal clients straight into Chapter 13, even though these debtors' true and reasonable expenses would make them unlikely to succeed in repaying old debt. This is one reason the Chapter 13 failure rate would likely rise.

5. Below Median Income Debtors

Under the legislation, a presumed abuse challenge could not be brought against a debtor who is below median income for the debtor’s family size in the debtor’s state, and only a judge or trustee could bring an abuse challenge against such a debtor. Judges and trustees would be unlikely to bring abuse challenges against below-median income debtors, yet these debtors would have to go through the burden of preparing a means-testing calculation showing net monthly income after permitted expenses, on pain of automatic dismissal. Attorneys preparing the calculation would face new liability. Furthermore, even though a presumed abuse challenge could not be brought against these debtors, the U.S. trustee apparently would have to file a statement as to whether each below-median-income debtor passed the

129. Id. § 102.
130. Id. § 102(a)(6)-(7).
131. Id. §§ 102, 315(b) & 316.
132. See infra Part IV.B.8.
presumed abuse test and provide a copy of this statement to all creditors. The legislation could have avoided imposing the costs of pointless paperwork, on debtors and U.S. trustees, by making debtors with income below the state median not subject to abuse challenges and by not requiring them to submit expenses under the means-testing calculation.

6. Means Test Applicable in Chapter 13

A debtor who is above the state median income for a family of that size would have to use IRS expense standards to determine expenses under the disposable income test of Section 1325(b). Because the IRS standards are so stringent, these debtors would have trouble keeping to their budgets and thus would be more likely to fail to complete their plans. Realistic budgets are key to plan success. Also, debtors above median income would have to undertake five-year plans unless they could make full payment in less time, up from three-year plans under the current disposable income test. With five-year plans, there is more opportunity for financial problems that prevent plan completion.

The anti-cramdown features of the proposed legislation would have complex effects on use of Chapter 13 that are hard to predict. The legislation would require full debt repayment on certain collateral even though the collateral is worth less than the debt and repayment of retail replacement value for all other collateral in individual cases. This would mean that Chapter 13 debtors would have to pay more to keep cars and other personal

133. See infra Part IV.B.7.
134. S. 420 § 102.
135. See Williams, supra note 124, at 7.
136. See supra note 12 and accompanying text.
138. S. 420 § 306 (requiring full debt repayment on purchase money obligations for a car acquired within three years before the bankruptcy filing and anything else acquired within one year before filing, even if the collateral is worth less than the debt); id. § 326 (setting the value of personal property collateral in individual cases in Chapters 7 and 13 at "replacement value," defined as "the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.").
139. Id. §§ 306 & 326.
property collateral (cramdown on home mortgages is already prohibited). Keeping personal property collateral would be less affordable in Chapter 13 than it is now. As a result, more debtors might propose unrealistic plans to try to save cars, and as a result, more might fail to complete their plans. It is hard to know whether Chapter 13 filings would decline. It is possible that because of the anti-cramdown provisions, below-median income debtors might be more likely than under current law to reaffirm in Chapter 7, with discharge of unsecured debts. On the other hand, if lawyers started to put more debtors directly into Chapter 13 because of the cost of going through means testing in Chapter 7, we might see more Chapter 13 filings by below-median income debtors. Their budgets would be stretched by the need to pay more to keep collateral, primarily cars, producing more failures.


Here is a non-exclusive list of additional paperwork that would be required under the legislation:

— As already noted, every debtor who filed in Chapter 7 would have to submit a means-testing calculation, even debtors below median income, and failure to file the calculation would make a debtor subject to automatic dismissal.140

— Every debtor in either chapter would have to submit a tax return.141 Trustees now often ask for a tax return at the first meeting of creditors, but this is not part of the court file and also is not something the debtor must produce to avoid dismissal. Because of the impact on privacy of the tax return requirement (e.g., names of dependents, Social Security numbers of taxpayer and dependents), the legislation directs the Administrative Office of the U.S. Courts to develop procedures to safeguard tax information and to prepare and submit to Congress a report assessing the effectiveness of its procedures.142

140. See Williams, supra note 124 (predicting that the legislation would either make a failed Chapter 13 a de facto prerequisite to Chapter 7 or that debtors would go underground and avoid repayment without benefit of bankruptcy).
141. S. 420 §§ 102, 315(b) & 316.
142. Id. §§ 315(e)(2) & 316.
143. Id. § 315(h)(1).
— In every Chapter 7 case, the U.S. trustee would have to file a statement as to whether the debtor's case would be a presumed abuse, and the court would be required to provide a copy of this statement to all creditors.\textsuperscript{144} There is no exception for below median income debtors, even though presumed abuse challenges could not be brought against them. With about a million consumer debtors a year filing in bankruptcy,\textsuperscript{145} these requirements would create a lot of paperwork and a lot of mail. Filing such a statement for every debtor is just one of the new jobs for U.S. trustees that will require new staff.\textsuperscript{146}

\textbf{8. Sanctions for Debtors' Lawyers}

Sanctions (payment for the costs of a dismissal action, including attorneys' fees, plus a civil penalty) could be awarded against a debtor's counsel if a case is dismissed as an abuse under Section 707(b) as amended and the court finds that the attorney violated Rule 9011 (the bankruptcy equivalent to Federal Rule of Civil Procedure 11).\textsuperscript{147} Giving this provision real punch is its statement that the attorney's signature on the petition "constitute[s] a certification that the attorney has... performed a reasonable investigation into the circumstances that gave rise to the petition... and... determined that the petition... is well grounded in fact... and... does not constitute an abuse."\textsuperscript{148} A possible interpretation of this language is that the attorney must conduct an investigation of the underlying facts. At its August 2001 meeting, the ABA House of Delegates voted to oppose the attorney sanctions provision of the legislation.\textsuperscript{149} The ABA was attuned to the ways in which this language interferes with the normal attorney-client relationship, in which an attorney may assume that a client is telling the truth absent information to the

\begin{itemize}
\item \textsuperscript{144} \textit{Id.} § 102.
\item \textsuperscript{145} See \textit{Bankruptcy Filings Set Record in 2001}, supra note 6.
\item \textsuperscript{146} See also infra pp. 442-44 (providing further examples of additional work created for the U.S. Trustee which would require new staff).
\item \textsuperscript{147} \textit{See S. 420} § 102.
\item \textsuperscript{148} \textit{Id.}
\end{itemize}
contrary and is not required to investigate the client. The language seems to require the attorney to investigate the underlying facts, such as the debtor's income and expenses.

9. Pre-Filing Debt Counseling and Preparation of a Budget

An individual debtor, to be eligible for bankruptcy in any chapter, would have to receive budget and credit counseling within the previous six months from a nonprofit agency that assisted the individual in performing a budget analysis. There are exceptions to this requirement of counseling for when the debtor has exigent circumstances and could not obtain counseling within five days of a request (there is no provision for an excuse within less than five days, for example to stop a foreclosure) and for districts where the U.S. trustee determines services are unavailable. Debtors subject to the counseling requirement would have to submit a certificate from the agency concerning receipt of the required services and a copy of a debt repayment plan, if any, developed by the agency. To qualify as an approved agency, a credit counseling agency's fees must be "reasonable" and they must provide services "without regard to ability to pay the fee." It is not clear that existing consumer credit counseling services will want to apply to help prepare people for bankruptcy. Credit counseling agencies, although non-profit organizations, are usually creditor-funded.

150. See id. (quoting the ABA resolution as criticizing the attorney liability provision for making bankruptcy work "dramatically riskier" for lawyers, as well as more expensive for clients, because it requires certification of accuracy.)
151. S. 420 § 106.
152. Id.
153. Id.
154. Id.
155. See Howard B. Hoffman, Consumer Bankruptcy Filers and Pre-Petition Consumer Credit Counseling: Is Congress Trying to Place the Fox in Charge of the Henhouse?, 54 Bus. Law. 1629, 1630-32 (1999) (stating that although run on a nonprofit basis, consumer credit counseling agencies ordinarily receive funding from creditors and that funding is based on a percentage of money recovered). Another problem with credit counseling is unrealistic plans. See id. at 1632, 1634-40 (noting that because creditors typically demand full repayment, debt management plans proposed by credit counselors are often unrealistic and unduly burdensome); see also Gordon Bermant, Planning for Change: Credit
10. Debtor Education as a Condition of Discharge

As a condition of discharge, all debtors in Chapter 7 and Chapter 13 would have to take a course in personal financial management. There is an exception for districts where the U.S. trustee has determined that there are not adequate services for all debtors. Financial management courses could be given by for-profit entities. The legislation provides no funding for counseling or education, so at least some debtors would end up paying for these services themselves.

11. Supervision of Counseling and Debtor Education Agencies

The legislation assigns the U.S. trustees supervisory authority over the agencies used by debtors in bankruptcy to satisfy the counseling and financial management education requirements. The legislation provides for evaluation and annual approval after "thorough review."

12. Homestead Cap

Although the Senate approved a cap on the homestead exemption of $125,000, this general cap was compromised in the conference committee in favor of a cap applicable only to certain debtors such as those convicted of felonies or liable under federal

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Counseling at the Threshold of Bankruptcy, 20 AM. BANKR. INST. J. 20, 21 (2001) (finding credit counseling agencies in one district used budget expense allowances even smaller than those in the IRS allowances); David A. Lander, Essay: A Snapshot of Two Systems That Are Trying to Help People in Financial Trouble, 7 AM. BANKR. INST. L. REV. 161, 178-81 (1999) (noting debt management plans typically require full debt payout and that, as of 1998, in forty-eight percent of plans, debtor stopped paying within first six months, sometimes in response to continued collection efforts by some creditors).

156. S. 420 § 106.
157. The exceptions for both counseling and debtor education when services are not available might be unnecessary because telephone and Internet services suffice for either requirement.
158. S. 420 § 106.
159. Id.
160. Id. § 308.
or state securities laws. The conference proposal also barred used of a homestead exemption by anyone who had not lived in a state for forty months before filing. This would still permit some debtors to make use of an unlimited homestead exemption, although most debtors in bankruptcy have little or no home equity. This issue is largely symbolic, given that very few debtors who file in bankruptcy have even $125,000 in home equity or other assets to put into a homestead in order to protect them. Still, having a high homestead exemption cap, or no limit at all, undercuts claims that the legislation is intended to force those with the means to do so to repay their debts.

C. Summary of Problems with the Legislation and Examples

Many of the problems with the legislation are indicated above. To summarize, all cases would cost more to process, for debtors and their attorneys and the system, even when debtors are below median income. Debtors, who are often disorganized, would have to get tax returns on file with the court to avoid dismissal. Attorneys would probably raise their fees because of the increased paperwork and risk of liability, at least initially. The presumed abuse calculation raises many questions of fact and mixed questions of fact and law (for example, what amounts are “reasonable and necessary” in certain categories). Where the first stage of review finds presumed abuse, there is a second stage possible to determine whether special circumstances justify adjustments to income or expenses, with the burden on the debtor to rebut a presumption of abuse. While the presumed abuse test is rigid and tough (for example, because of use of the IRS standards for expenses), it is subject to discretionary review in this “special circumstances” inquiry, but the two-step process (presumed

161. See Shenon, supra note 113.
162. See id.
163. Although one can find reported cases involving high-income debtors who have sheltered large amounts in homes, these are outliers to the great mass of consumer debtors. One-quarter of homeowners in bankruptcy have no equity, and more than two-thirds are “house poor” under Fannie Mae guidelines for housing expenditures. Sullivan et al., Fragile Middle Class, supra note 31, at 221, 218-19.
abuse/special circumstances) would require debtors to be able to pay for litigation to avoid dismissal. The U.S. trustees and their umbrella agency, the Executive Office for the U.S. Trustees, would have many new duties to execute and studies to make. Trustees would have to file statements concerning abuse in every Chapter 7 case and oversee credit counseling and financial management education for all debtors in both chapters. The bankruptcy bureaucracy would swell. Some debtors who need relief would not be able to afford it, and there would be more Chapter 13 failures as lawyers put more clients directly into Chapter 13 to avoid the costs and uncertainties under Chapter 7.

To get a feel for how these provisions might work, consider three examples:

Example 1
Debtor received $3000 per month in income for the last six months. (This is $36,000 a year). Debtor has monthly expenses, under the IRS standards and other means-testing calculations, of $2900. Debtor, a single mother with one child, has $30,000 in unsecured debts from credit cards and uninsured medical expenses due to a serious illness and hospitalization her child suffered while Debtor was out of work last year. (Studies indicated that about two-thirds of debtors report job disruptions as a cause of their bankruptcies, and nearly half of bankruptcies involve medical problems). Assume Debtor falls above median income for a family of two in her state. Because Debtor has $100 per month in "excess income," she is a presumed abuser who (in theory) could pay $6000 in a five-year Chapter 13 case (her payments would be less than twenty-five percent of unsecured debt). Debtor might attempt to rebut the presumption of abuse. She could argue, for example, that she has higher transportation costs than the IRS standards because she must drive a long distance to work and that the IRS standards do not cover her actual food and clothing expenses, which she maintains are reasonable. Presumably, her lawyer would charge more for this sort of case than for a Chapter 7 under current law, and Debtor might not be able to afford the

164. Id. at 15-21.
165. See Jacoby et al., supra note 91, at 377.
higher fee. Alternatively, her lawyer might put her directly into a five-year Chapter 13 with disposable income calculated under the IRS standards. Under current law, probably no judge or U.S. trustee would bring a “substantial abuse” challenge against this debtor.

For a variation on Example 1, assume instead that Debtor is part of a family of four and is below median income. Debtor is not subject to a presumed abuse challenge but must still submit a means-testing calculation, which her lawyer must certify after investigation, and also a copy of a tax return. If Debtor receives income that is difficult to verify (tips, for example), the lawyer may be nervous about the certification. The greater paperwork and risk for the lawyer would likely raise the attorney’s fee. Debtor would have to go through credit counseling before filing and debtor education afterward. The additional costs and burdens as a practical matter might mean no access to bankruptcy.

Example 2

Debtor makes $50,000 a year. Assume that is above the state median income. The calculation of Debtor’s income compared to expenses shows $500 in surplus income. If, however, Debtor had recently bought a new car on which he pays $450 per month, the surplus income would be reduced to $50. That means $3000 is available (in theory) over five years ($600 per year), so that Debtor could pass the means test if he has more than $12,000 in unsecured debt (so that he would pay less than twenty-five percent of unsecured debt in five years). This example illustrates that debtors with more secured and unsecured debt pass the presumed abuse test more easily. It is odd that legislation supposedly designed to catch abuse makes it easier to qualify for bankruptcy by buying a new car.¹⁶⁶

Example 3

Debtor made $72,000 per year take-home pay working as an assistant hotel manager. Debtor was laid off a month ago and has just gone back to work supervising banquet set-up at half his old

¹⁶⁶. A creditor could still charge abuse, but a “totality of the circumstances” test would apply. S. 420 § 102(a).
salary. For the first five months of the "current monthly income" period, Debtor's income will be $6000, and for the last month it will be zero, for a calculation of $5000 per month in current monthly income. On $5000 a month, Debtor exceeds the presumed abuse test and is above median income. He can attempt to rebut the presumption of abuse by showing the "special circumstance" of actual income of $3000.

Debtor, who is hoping to get bumped back up into senior management of the hotel when business picks up, has an application in for his old position and has been told there is a good chance that he will get it in six months, when the busy season gets into full swing. There would be a difficult issue of whether to report a "reasonably anticipated increase" in income within twelve months.

(A variation is a debtor who manages to file just before getting a new job, after being out of work for six months. This debtor would have zero income under the means test and would easily pass it. Timing of one's bankruptcy filing is strategically important under this income definition involving a six month look-back, an approach that will sometimes either over- or understate means to pay in the future.)

V. THE NEED FOR SIMPLIFICATION, INCLUDING A SINGLE PORTAL

The current consumer bankruptcy system is much too complex. Examination of how the two main consumer options, Chapters 7 and 13, are actually used reveals that they lack distinctive characters.\textsuperscript{167} The two chapters are not separating the "can" from the "can't" pay.\textsuperscript{168} A major reason for use of Chapter 13 is to hold on to collateral, but debtors who have not defaulted on secured obligations can often do that in Chapter 7, either by court-protected ride-through or because of creditor acquiescence.\textsuperscript{169} Debtors who retain collateral in Chapter 7 do not have to

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{167} See Braucher, Increasing Uniformity, supra note 65, at 11-14 (describing consumer bankruptcy law as providing a complex mix of overlapping options).
\item \textsuperscript{168} See Sullivan ET AL., As WE FORGIVE, supra note 4, at 239-40.
\item \textsuperscript{169} See Culhane & White, Reaffirmation, supra note 6 (explaining that a majority of sample debtors with homes and cars held on to them in Chapter 7 without reaffirming).
\end{enumerate}
\end{footnotesize}
undertake repayment plans, as Chapter 13 debtors do, typically including some portion of unsecured debts. As a result, under current law, some of the worst off debtors, those who have defaulted on secured obligations, end up in Chapter 13 as the only way to hold on to a house or car, and they are then saddled with arrearage payments on overdue secured debt as well as partial repayment of unsecured debt.

Furthermore, the image that Chapter 7 involves a pure fresh start and Chapter 13 involves repaying unsecured debts is flawed. Some repayment goes on in both chapters, and it is by no means clear that more repayment occurs in Chapter 13, when one takes into account failed plans and plans with minimal repayment to unsecured creditors and also the repayment that occurs in Chapter 7.

The proposed legislation would take this confused and confusing system and make it more complicated and more onerous to debtors, even the worst off and most clearly in need of a fresh start, despite absence of evidence of new abuse. The resulting law would increase costs for all, denying access to bankruptcy at the margin and putting more can't-pay debtors into repayment plans that fail. Yet the law would fail to stop manipulations that allow some can-pay debtors to escape repayment. Simplification is needed. A single portal into bankruptcy is an obvious key element in a workable solution.

Elizabeth Warren, the reporter for the National Bankruptcy Review Commission, briefly floated the idea of a single consumer

170. See 11 U.S.C. § 1325(b) (2000) (requiring commitment of disposable income to payment plan for three years to avoid confirmation challenge, unless debtor is paying creditors one hundred percent of their debts in less time).
171. See id. §§ 1325(b) & 1322(b)(5) (concerning curing defaults).
172. See supra note 9 (concerning non-completion rate in Chapter 13); Braucher, Lawyers and Consumer Bankruptcy, supra note 12, at 531-32 (concerning local variations in acceptability of low percentage plans in Chapter 13).
173. See supra note 6.
174. See supra Part II.
175. See supra notes 48-59 and accompanying text; see also Part IV.B.6.
176. See supra Part IV.C, Ex. 2.
chapter, called Basic Bankruptcy. The organized affected interests all disliked the idea. Debtors’ lawyers stood to lose Chapter 13 business, and Chapter 13 trustees stood to lose their posts. Creditors would gain more from means testing Chapter 7, pressuring more debtors into the troubled Chapter 13 system, which produces many fewer discharges than filings, and deterring some debtors from filing at all. Also, because the particular single chapter proposed as Basic Bankruptcy was in essence Chapter 7, with options added to pay over time to keep collateral or to make voluntary payment to unsecured creditors, at first blush it appeared too debtor-oriented. But the single portal idea has

177. See Basic Bankruptcy Concept Being Considered by the Consumer Bankruptcy Working Group, 6 CONS. BANKR. NEWS, Sept. 12, 1996, at 2 [hereinafter Basic Bankruptcy] (providing a summary prepared by Elizabeth Warren, reporter for the National Bankruptcy Review Commission and also Harvard Law School professor, concerning proposal considered by the commission).


179. The reasons given by the NACBA and NACTT, see supra note 178, were not self-interested, but rather focused on arguments that current law is working well and that non-uniformity in application of bankruptcy law is an inevitable consequence of judicial discretion, which has the salutary effect of permitting adaptation to different state laws and regional economic conditions. NACTT further noted that the Basic Bankruptcy concept was supported only by “academicians.” (A law professor knows she is in trouble when she is called an “academician.”). See NACTT Responds to Basic Bankruptcy Plan, supra note 178. However, the idea of a single portal did receive an endorsement from a prominent bankruptcy judge. NCBJ President Offers His Vision of a Single Chapter Consumer Bankruptcy System, 6 CONS. BANKR. NEWS, Oct. 24, 1996, at 5 (concerning proposal of Judge Robert D. Martin of the Western District of Wisconsin for a single chapter, involving nonexempt asset surrender by all debtors, with option for installment redemption of collateral and further option for payment of disposable income for forty-eight months to get superdischarge, including of obligations for taxes, alimony and support).

180. See supra notes 48-59 and accompanying text.

181. As summarized by Professor Warren, see supra note 177, the Basic Bankruptcy concept would have involved having all debtors file in one chapter and receive a discharge. Under the concept, there would be other, delinked
merit apart from the details of the Basic Bankruptcy concept. A single portal is probably the only way to do a better job both of providing reasonably consistent treatment for the similarly situated and identifying, at least cost, those who realistically could afford to use part of current income to repay old debt.

Both current and proposed means testing use an approach in which the more debt one has, the less likely one is to have to repay. Currently under the "substantial abuse" test, both case law and the informal practices of U.S. trustees operating under rules of thumb consider what percentage of unsecured debt a Chapter 7 debtor could repay in Chapter 13. The means testing in the proposed legislation would continue this approach, by excluding a debtor from Chapter 7 if that debtor could pay twenty-five percent of unsecured debt in five years and, more importantly, by deducting secured claim amounts from income to determine ability to repay. It is perverse to require repayment of debtors because they have incurred less debt than others. Incurring more secured debt is a way to pass the presumed abuse test of the proposed legislation. Other expenses would, to some extent, be objectively judged (under the IRS standards) on this first cut, but some expenses would be determined by "actual" and "reasonable"

options in bankruptcy—curing a home mortgage, paying for a car to keep it, and voluntary repayment to general creditors (with a special benefit for those who repaid 100%, that a credit reporting agency could not continue to list the bankruptcy). See id. There were also a few "get tough" aspects to the concept—eliminating the ability to refile for six years after dismissal and instituting random audits of debtors' schedules. See id.

182. The idea of a single portal predates the Basic Bankruptcy concept. Kenneth Klee, then chair of the National Bankruptcy Conference's legislative committee and now a law professor at the University of California at Los Angeles, suggested it in 1994, in conjunction with a proposal to have an administrative agency handle consumer bankruptcy cases. See Should Consumer Bankruptcy Be An Administrative Procedure? 4 CONS. BANKR. NEWS, Nov. 10, 1994 (concerning Klee's proposal and tracing it to a study by the Brookings Institution in the 1960s recommending that an administrative agency be responsible for determining which debtors are entitled to relief and the form of relief and for administering cases).

183. See supra notes 101-104 and accompanying text.

184. See S. 420 § 102; see supra Parts IV.B.2 & C., Ex.2.

185. See supra Parts IV.B.2. & C., Ex. 2.
expenses, so that upping expenses would help to pass the test. If a debtor failed the presumed abuse test and went on to the rebuttal phase, the debtor still could try to get higher expenses approved based on special circumstances.\textsuperscript{186}

Chapter 13 system has a similar problem. The more “reasonably necessary” expenses a debtor has, the less disposable income he has and the less he must pay. The proposed legislation continues this approach for those at or below state median income.\textsuperscript{187} For those above median income, it would use the presumed abuse test for Chapter 7 to determine ability to pay,\textsuperscript{188} thus incorporating its elements making payment depend on secured debt and some expenses at actual and reasonable levels, or determined on the basis of special circumstances.

An approach that might be fairer and easier to administer would be to make repayment depend primarily on income, but with enough leeway that there is no need to have many debtors resorting to special pleading, as in the rebuttal phase of the proposed means testing. Setting required repayment as a percentage of income fits this bill.\textsuperscript{189} A fine-tuned approach might use a sliding scale, with a graduated percentage of income as income rises.\textsuperscript{190} A rougher approach would set a percentage repayment above an income threshold, such as state median income. In addition to its greater fairness, an advantage of an income-based repayment requirement is that it reduces the need for judicial inquiry into lifestyle choices.\textsuperscript{191}

An income-based approach is used in Australia, where the

\begin{footnotes}
\item 186. See supra Part IV.B.2.
\item 187. See S. 420 § 102.
\item 188. See id.
\item 189. The National Bankruptcy Review Commission came up with such a proposal for Chapter 13—that unsecured debt repayment be set by a sliding percentage of adjusted gross income, from a nominal amount for those with low income (below $20,000) to five percent of adjusted gross income for debtors with income in excess of $75,000. See NBRC REPORT, supra note 3, at 262-73. To adapt this approach to a single portal form of consumer bankruptcy and to make repayment realistic, the length of the repayment period should not be too long, as is discussed in the text infra.
\item 190. See id.
\item 191. See id. at 263-64 (concerning differing judicial views of what expenses are reasonably necessary).
\end{footnotes}
trustee in bankruptcy has the task of assessing a contribution of half of debtors' income above a certain income threshold, which is based on family size. The contribution goes to pay unsecured creditors, and the assessment period is for twelve months and can be renewed during the period until discharge, which typically comes three years after the filing of a statement of affairs. This system may appear more strict than ours, in that the discharge is conditional on repayment. But it turns out that less than three percent of Australian bankruptcy estates have an assessment made against them. The rest are below the income threshold. Those who are assessed can bring a hardship appeal based on high expenses or other reasons, a process pursued by very few debtors.

Since amendments to its bankruptcy law in 1997, Canada also puts its debtors through a surplus income test. As administered by the Superintendent of Bankruptcy, the Canadian approach appears to set surplus income at a level that is problematic in more cases than in Australia. There has been criticism that when the

192. See John Duns & Rosalind Mason, Consumer Insolvency in Australia, 10 INTERN. INSOLVENCY REV. 195, 212-13 (2001) (discussing implementation of regime of automatic assessment of income contributions as of July 1992). Australia also has alternatives to bankruptcy in the form of insolvency arrangements or agreements, in which the debtor makes a proposal that is put to a vote by creditors, with approval required by a majority in number and seventy-five percent in amount). See id. at 224-25.

193. See id. at 213 (concerning mechanics of assessment); id. 217-18, 220 (noting that discharge is automatic after three years, unless it occurs by earlier application or is postponed due to filing of objection; in 1999-2000, there were 7641 successful applications for early discharge and 301 objections to discharge). Given that there were nearly 24,000 filings in bankruptcy in Australia in 2000-2001, id. at 195, most discharges are automatic.

194. See id. at 216 (reporting that only 2.8% of bankruptcy estates under administration for all or part of the year 1999-2000 had contributions assessed).

195. See id. (reporting that forty-four appeals of assessments were brought in 1999-2000, nineteen of them successful).

196. See Jacob S. Ziegel, The Philosophy and Design of Contemporary Consumer Bankruptcy Systems: A Canada-US Comparison, 37 OSGOODE HALL L.J. 205, 225 (1999) (stating that trustee determines income after taxes and certain other expenses such as child support and spousal maintenance, and then living expenses based on a low-income standard are deducted).

197. See id. at 227 n.93 (reporting that initial data from Toronto in 1998, after adoption of the surplus income test, indicated that 14.4% of debtors had surplus
superintendent's guidelines for expenses seem inappropriate in a particular case, the trustee has no discretion and the remedy available is mediation and, failing that, a court hearing.\textsuperscript{198} The rigidity of the surplus income test is somewhat ameliorated by the fact that when payment is required, it is typically for only nine months after the debtor files a case.\textsuperscript{199} Also, Canada uses the same technique of requiring repayment of half of surplus income.\textsuperscript{200} In Canada, half of the surplus income must be paid where the surplus is from $100 to $1000; if monthly surplus income is less than $100, no repayment is required.\textsuperscript{201} Thus, for example, debtors with $300 in surplus income per month would have to pay $150 per month to old creditors, leaving a $150 cushion against too stringent expense figures used in the surplus income calculation.

In addition to some discontent with the surplus income test, Canada's system is less than ideal for a number of other reasons, including that trustees charge substantial fees to debtors even though they in theory are fiduciaries for creditors\textsuperscript{202} and that a controversial counseling requirement has added administrative costs to an already expensive system.\textsuperscript{203}

If one applied family income thresholds, as in Australia, to American debtors and set them at or slightly above median income, it might be possible to efficiently pick out debtors most likely to be able to pay something, allowing the others to proceed to discharge with little interference.\textsuperscript{204} Requiring debtors above the

\textsuperscript{198} See id. at 227.
\textsuperscript{199} See id. at 213, 230-31 (requiring payment from bankruptcy to discharge, which occurs in nine months in first-time cases where no objection is filed).
\textsuperscript{200} See id. at 225.
\textsuperscript{201} See id.
\textsuperscript{202} See Ramsay, supra note 59, at 73 (providing for median trustee remuneration of $1491); see also Ziegel, supra note 196, at 214-15 (noting possible conflicts of interest).
\textsuperscript{203} See Ziegel, supra note 196, at 255; see also Ruth E. Berry, Counselling Consumer Debtors Under Canada's Bankruptcy and Insolvency Act, 37 OSGOODE HALL L.J. 369 (1999); Curnock, supra note 97.
\textsuperscript{204} See Culhane & White, Means Testing, supra note 4, at 37 (using a national median income test on real debtors in Chapter 7, about twenty-four percent were
income thresholds to pay half of the excess, for nine or twelve months, would be much more realistic than pushing them into five-year plans requiring payment of all income in excess of stringent, unrealistic expense guidelines.\textsuperscript{205} An appropriate income threshold, an assessment of half the excess for those above it, and a short, achievable repayment period would minimize the need for special hardship pleading and would also reduce failure. If all debtors came through the same portal and were put through a reasonable threshold income test, many debtors who currently try and fail to repay in Chapter 13 would not be put through that humiliation because they would be below the income threshold for repayment.\textsuperscript{206} Chapter 13 debtors as a group are not better off than Chapter 7 debtors,\textsuperscript{207} and many are worse off.\textsuperscript{208} Means testing them, too, would eliminate a lot of the failure in repayment that currently occurs. In a one-portal system, the income level for repayment and amounts of repayment required could be set so that, at the end of the day, a somewhat larger portion of debtors would be required to make some repayment than currently succeed in doing so.

\textbf{CONCLUSION}

If better means testing is wanted, attention needs to be paid to the means of achieving it, so that the worst off and most in need of

\textsuperscript{205} See supra note 9 (concerning high failure rate in Chapter 13 currently, under less stringent expense standards than would apply to debtors means tested into Chapter 13 by the proposed legislation); see also Part IV.B.6 (concerning applicability of means testing in Chapter 13 under proposed legislation).

\textsuperscript{206} See Braucher, Counseling Consumer Debtors, supra note 43, at 191 (noting blow to self-esteem from failing even in bankruptcy).

\textsuperscript{207} See SULLIVAN ET AL., AS WE FORGIVE, supra note 4, at 239-40; see also Teresa A. Sullivan et al., Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991, 68 AM. BANKR. L.J. 121, 142 (1994) (noting that non-mortgage debt-income ratios for both Chapter 7 and Chapter 13 debtors were statistically indistinguishable between 1981 and 1991).

\textsuperscript{208} See text accompanying supra notes 167-171.
a fresh start are not priced out of the consumer bankruptcy system. One can think of ways to make the system simpler, fairer, less expensive to administer, less costly to access and more understandable to consumers. A single portal for consumer debtors (rather than two options, Chapter 7 and Chapter 13) is key to making these gains. A threshold income test for repayment could then be applied to all debtors. Thinking about the design of such a simplified system provides an interesting and revealing contrast to the proposed legislation, which would be a step in the wrong direction, making consumer bankruptcy even more complicated, costly, and hard to understand than it already is.
Notes & Observations